Supreme Court, U.S.
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No. 90-1312

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

AMERICAN UNDERWRITERS GROUP, INC.,

Petitioner,

v.

HARRY E. EAKIN, as the Insurance Commissioner of the Department of Insurance of the State of Indiana,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE INDIANA COURT OF APPEALS

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether the Indiana Court of Appeals considered and decided a federal question?

II. Whether American Underwriters Group, Inc., is an insurance company within the meaning of 11 U.S.C. § 109(b) and, therefore, excluded from federal bankruptcy relief?

III. Whether Indiana Code § 27-9 is preempted by the Bankruptcy Code?

IV. Whether a substantial federal question has been raised?

LIST OF PARTIES

The caption of the case in this Court contains the names of all parties to the judgment of the Indiana Court of Appeals. Harry E. Eakin, as the Insurance Commissioner of the Department of Insurance of the State of Indiana, at the time that the Petition for Rehabilitation of American Underwriter's Group was filed and who has since been succeeded by John J. Dillon, III, ("Commissioner"), has no parent companies or subsidiaries to be listed pursuant to Rule 29.1.

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Respondent, Harry E. Eakin, as the Insurance Commissioner of the Department of Insurance of the State of Indiana, at the time that the Petition for Rehabilitation of American Underwriter's Group was originally filed, ("Commissioner") respectfully prays that the Petition for Writ of Certiorari be denied.

JURISDICTION

American Underwriters Group, Inc., ("AUG") has sought to invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1257(a). As will be set forth in detail below, this Court lacks jurisdiction to review this matter. The Indiana Court of Appeals did not decide a federal question. The question now raised by AUG was not properly raised by AUG before the Indiana trial court or the

Indiana Court of Appeals. By AUG's own admission, this question was not raised until twenty (20) days after the Indiana Court of Appeals' decision was rendered when AUG filed a petition for rehearing. The raising of a federal question for the first time in a petition for rehearing is insufficient. This Court is without jurisdiction of this matter and it must be dismissed.

STATEMENT OF THE CASE

AUG is the attorney-in-fact for AIE, an Indiana interinsurance exchange organized pursuant to I.C. § 27-6-6-1 et seq. Pursuant to Indiana's interinsurance statutes, the policyholders of AIE, called "subscribers", are authorized to exchange reciprocal or interinsurance contracts with each other or others. These contracts are executed by an

attorney, in this instance AUG, who is authorized by and acts on behalf of the subscribers. I.C. § 27-6-6-2.

The relationship between AUG and AIE's subscribers is set forth in a document entitled "Power of Attorney and Subscriber's Agreement", a copy of which is filed with the Department of Insurance and attached to each policy issued to AIE subscribers. Pursuant to this Power of Attorney, AUG is authorized as follows:

> Subscriber authorizes Attorney-in-Fact, on Subscriber's behalf, to effect, modify and terminate contracts containing such terms as Attorney-in-Fact may deem suitable to provide any and all forms of insurance; to collect all monies due; to give, waive, or receive all notices and proof of losses; to settle all losses and claims under insurance contracts herein authorized; to cede and assume reinsurance; to accept and authorize others to accept service of process and appear in behalf of Subscriber in any suits, actions or proceedings, and to bring, prosecute, defend or otherwise

> settle suits, actions or proceedings; to perform every act not herein specified that the Subscriber could individually perform in relation to any contract herein authorized, appropriate to its proper and lawful execution and performance; . . .
>
> * * *
>
> Subscriber authorizes the Attorney-in-Fact to pay out of the funds of Subscriber the cost of reinsurance, collection expense, investment expenses, losses, damages, judgments, court costs, legal expenses, loss adjustment expenses, license fees, taxes, inspection expenses, audits, examinations, rating bureaus, insurance trade and service organizations, bonds as required herein, brokerage and agency expenses and commissions.

All premiums collected by AUG on policies issued by AIE were deposited in an account maintained under the name of AUG as attorney-in-fact for AIE. The principal signatories on the account, with the possible exception of one, were employees of AUG.

From time to time an exchange of assets was made between AUG and AIE. In 1980, AUG as attorney-in-fact for AIE loaned itself $1,600,000 of AIE funds for the purpose of purchasing a subsidiary of AIE. The loan was subsequently repaid by a donation of stock of two insurance subsidiaries owned by AUG.

The relationship between AUG and AIE is further described in various documents authored by AUG. AUG was incorporated in 1964 and its primary purpose, as set forth in its 1971 Amended Articles of Incorporation, is as follows:

> To act as Attorney-in-Fact for a reciprocal insurer and to exchange, negotiate, solicit and execute reciprocal or interinsurance contracts among individuals, partnerships, associations and corporations, as Subscribers . . . and in general to do all other things necessary, incidental and convenient to conducting an insurance business as Attorney-in-Fact for a reciprocal insurer.

As a corporation regulated by the Securities and Exchange Commission, AUG files a Form 10-K on an annual basis. In its 1987 Form 10-K, AUG stated as follows regarding its relationship to AIE:

> Although the Company does not own the Exchange, its relationship thereto may be regarded as perpetual, or until dissolution, inasmuch as the Exchange exists by reason of its creation, financing, management and maintenance by the Company. The Exchange has no capacity to act except through the Company as its Attorney-in-Fact.
>
> * * *
>
> Due to the Company's dependence on the viability of Exchange and because of the close relationship and transactions with the Exchange, financial statements of the Exchange are also presented in this report.

The power of attorney and subscribers agreement authorizes AUG to deduct for itself up to 15% of all monies received or due to AIE as a fee for its services.

From time to time, AUG overpaid itself the attorney-in-fact fee. As of April 30, 1987 the overpayment amounted to $443,000. As of December 31, 1987 the overpayment amounted to $91,000.

In AUG's 1986 annual report, AUG stated with regard to the impact of regulation by the Department:

> Although it is not possible to predict the effects of the agreed order of supervision on the Exchange or the Company, it is probable that, unless the Exchange is able to substantially increase its surplus or obtain quota-share reinsurance on favorable terms, or a combination thereof, the Indiana Department of Insurance may restrict all writings of new and renewal business of the Exchange. This restriction would have the effect of substantially eliminating the attorney-in-fact fees from the Exchange to the Company which are largely based on premiums written by the Exchange, as described below. If the Indiana Department of Insurance follows this course of action, it could ultimately lead to the runoff of the business-in-force of the

> Exchange and the liquidation of both the Company and the Exchange.

The Department issued a Certificate of Authority to AUG authorizing AUG to make contracts of insurance. As set forth by statute:

> No certificate of authority shall be issued under this section unless and until the subscribers and the attorney shall have complied with the same character and fitness qualifications, plan of operation, and standards for officers and directors as is required of stock and mutual insurance companies under this title."

I.C. § 27-6-6-9. The inter-insurance certificate of authority issued by the Department states in part that AUG:

> . . . is hereby authorized and empowered to issue and exchange contracts of inter-insurance under the name and designation of American Inter-Insurance Exchange at Indianapolis in the State of Indiana insuring the members of such exchange in this state against loss . . . for the year ending perpetual unless suspended or revoked.

AUG's obligations and duties to the subscribers of AIE are regulated by statute. Pursuant to I.C. § 27-6-6-3, the subscribers, through AUG, are required to file with the Department of Insurance a declaration verified by the oath of AUG setting forth that there is in the possession of AUG and available for the payment of losses, assets conforming to the requirements of Section 6 of this Act. Section 6 provides that if at any time the assets shall be less than required, "the subscribers or their attorney for them shall make up the deficiency within 30 days after notice from the department of insurance. . . ."

From December 12, 1973, to June 22, 1979, AUG injected $8 million into AIE evidenced by the guarantee fund certificates issued by AUG, each of which provides:

> The principle sum represented by this guarantee fund certificate and the interest thereon shall be repaid only out of the surplus, earnings or profits of the exchange with the approval of the Department of Insurance of the State of Indiana whenever in its judgment the financial condition of the exchange shall warrant, but such approval shall not be withheld if after such repayment shall be made, the exchange shall have and be in possession of a surplus as regards policyholders equal to ten percent or more of the gross annual premium of these subscribers at the exchange.

Among other duties, AUG is authorized and required to maintain all financial information with regard to the affairs of AIE. Pursuant to I.C. § 27-6-6-7, AUG is required to annually report to the Department, under oath, as to the financial condition of the office where the contracts are issued and shall further report as required. The annual statement for year-end 1987 was filed by AUG with the Department of Insurance.

The truth of the statements contained therein were sworn to by the president, secretary and treasurer of AUG as "officers of the said insurer."

I.C. § 27-6-6-7 provides that, "[t]he business affairs, records, and assets of any such organization shall be subject to examination by the insurance department at any reasonable time, and such examination shall be at the expense of the organization examined." Among the documents submitted by AUG to the Department of Insurance over the last ten years were registration statements required of insurance holding companies, which contain information about the entity controlling the insurance, along with separate biographical affidavits filed by AUG's officers and directors.

I.C. § 27-6-6-11 provides that the attorney's failure or refusal to comply with any of the provisions of this chapter shall result in the refusal, suspension or revocation of the Certificate of Authority by the Department after notice and opportunity for hearing has been given so that the attorney may appear and show cause why such action should not be taken.

I.C. § 27-6-6-15 authorizes AUG on behalf of the subscribers to borrow or assume a loan or advance for certain purposes, and further sets forth the conditions under which the loan may be repaid. The Department may withhold its approval of any repayment "whenever in its judgment the financial condition of the attorney for the subscribers at such exchange shall warrant." Finally, I.C.

§ 27-6-7-1 provides that AIE may only sue or be sued through its Attorney-in-Fact, AUG.

On April 6, 1988, the Commissioner filed a Verified Petition for Order of Rehabilitation of AIE. On that same day, AIE was placed into rehabilitation, after consent was given by the Board of Directors of AUG, pursuant to I.C. § 27-9-3-1, which provides that the Commissioner may request an order authorizing him to rehabilitate a domestic insurer on the grounds that:

> (12) The board of directors or the holders of a majority of the shares entitled to vote, or a majority of those individuals entitled to the control of those entities, request or consent to rehabilitation under this article.

On April 14, 1988 the Commissioner petitioned the Court for the seizure of AUG pursuant to I.C. § 27-9-2-2 which

provides that the Commissioner may file such petition with respect to a domestic insurer. AUG complied with the Order of Seizure and made no formal request for a hearing to review the order of seizure.

On May 4, 1988, the Commissioner filed a Petition for Order of Rehabilitation of AUG, on the ground that reasonable cause existed to believe that AUG was in such condition as to render the continuance of its business financially hazardous to the public, to the subscribers of AIE, and to its creditors. A hearing was held August 9, 1988, at which time evidence was presented by both parties. Mark Tharp, Special Deputy to the Rehabilitator, testified that AIE held a 9%, $750,000 debenture due from AUG on June 29, 1988. Demand for payment was made on AUG, which obligation has not been fully paid. It

was Mr. Tharp's opinion, as a CPA, that AUG was insolvent by approximately $370,000 at March 31, 1988.

Dan Warfel, a partner with Peat Marwick Main & Company, testified at the hearing with regard to the relationship between AUG and AIE and the continuing ability of AUG to affect the financial condition of AIE. Warfel described his review of the financial information submitted by AUG to the Securities Exchange Commission for 1986, 1987 and 1988. He stated that the relationship between AIE and AUG dictates that the financial statements for both operations be set forth together and that the financial operations of AIE and AUG are intimately related from an investor, tax and financial standpoint.

Warfel further testified as to the tax election available to AIE and AUG

pursuant to § 826 (currently codified at § 835) of the Internal Revenue Code. The effect of this election is to consolidate the tax returns of AIE and AUG even though the returns are not technically consolidated. It permits AIE to be given a refund or credit for taxes paid by AUG. Under this election, if AUG were to experience a tax loss, it could carry that tax loss back three years or forward up to 15 years. If that were to happen, Warfel concluded the IRS then could pursue AIE for reimbursement of the refund or credits that the IRS had paid during those previous years which AIE had received as a result of the taxes paid by AUG.

On August 31, 1988, the trial Court denied the Commissioner's Petition for the Rehabilitation of AUG. On September 7, 1988, the Court directed entry of a

Final Judgment. On the same date, AUG informed the liquidator of AIE that it had filed an application with the IRS to carry back a 1987 net operating loss, thereby generating a refund of taxes paid by AUG in prior years. This action was taken without prior consultation with the Department as promised by counsel for AUG. On October 31, 1988, AUG received a tentative refund of approximately $2,000,000 with interest from the IRS, which remains subject to final determination by the Internal Revenue Service.

On April 10, 1990, the Indiana Court of Appeals determined that AUG was subject to Indiana's rehabilitation laws as an entity which was "doing business" as an "insurer" as those terms were defined under Indiana's insurance laws and reversed the trial court's

September 2, 1988 judgment. AUG's Petitions for Rehearing and for Transfer were denied.

REASONS WHY THE PETITION SHOULD BE DENIED

I. The Indiana Court of Appeals did not consider or decide a federal question.

AUG contends this Court's certiorari jurisdiction derives from 28 U.S.C. § 1257(a) which provides "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court by writ of certiorari where . . . a statute of any state is drawn in question on the ground of its being repugnant to the Constitution . . ." Jurisdiction under this section must fail if both requirements, that a federal question be raised and decided in the state court below, do not appear on the

record. Illinois v. Gates, 462 U.S. 213, 217-218 (1983). In McGoldrick v. Compagnie General Transatlantique, 309 U.S. 430, 434-435 (1940), the Court observed:

> But it is also the settled practice of this Court, in the exercise of its appellate jurisdiction, that it is only in exceptional cases, and then only in cases coming from the federal courts, that it considers questions urged by petitioner or appellant not pressed or passed upon in the courts below . . . . In cases coming here from state courts in which a state statute is assailed as unconstitutional, there are reasons of peculiar force which should lead us to refrain from deciding questions not presented or decided in the highest court of the state whose judicial action we are called upon to review. Apart from the reluctance with which every court should proceed to set aside legislation as unconstitutional on grounds not properly presented, due regard for the appropriate relationship of this Court to state courts requires us to decline to consider and decide questions affecting the validity of state statutes not urged or considered there.

In Cardinale v. Louisiana, 394 U.S. 437, 439, this Court considered the reasons behind this rule:

> Questions not raised below are those on which the record is very likely to be inadequate, since it certainly was not compiled with those questions in mind. And in a federal system it is important that state courts be given the first opportunity to consider the applicability of state statutes in light of the constitutional challenge, since the statute may be construed in a way which saves their constitutionality. Or the issue may be blocked by an adequate state ground. Even though States are not free to avoid constitutional issues on inadequate state grounds, (citation omitted) they should be given the first opportunity to consider them.

In this case, it is clear from a review of the Indiana Court of Appeals' opinion that it did not consider or decide the question now urged by AUG. The issues which the Indiana Court of Appeals decided were set forth on the first page of its decision:

ISSUES

1. Whether AUG, the attorney-in-fact for American Interinsurance Exchange (AIE), an unincorporated association in rehabilitation, is subject to the provisions of I.C. 27-9 providing for delinquency proceedings by the Commissioner.

2. Whether the Commissioner met his burden of proving AUG is in such condition as to render the continuance of its business financially hazardous to its policy-holders, creditors or the public.

(Appendix A-2.) Conspicuously absent from the Indiana Court of Appeals' opinion is any citation or reference to the Supremacy Clause or Section 109 of the Bankruptcy Code, the constitutional and statutory provisions which AUG now claims are involved. In its decision, the Indiana Court of Appeals stated that the first issue to be determined was one of statutory construction -- Indiana

statutory construction. The Court was called upon to construe the application of Ind. Code § 27-9-1 et seq. to an attorney-in-fact for an interinsurance exchange. It was never asked to consider nor did it decide whether its construction of Ind. Code § 27-9-1 et seq. was preempted by the Bankruptcy Code.

This Court has stated that when the highest court of a state has failed to pass upon a federal question, it will be assumed that the omission was due to want of proper presentation in the state court, unless the aggrieved party in this Court can affirmatively show the contrary.[1/] Street v. New York, 394 U.S. 576, 582 (1969); Bailey v. Anderson,

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1/ AUG has not provided this Court with a certificate from the Indiana Court of Appeals showing that a federal question was raised and decided. It could not because no federal question was considered by the Indiana Courts.

326 U.S. 203, 206-207 (1945). In this case, AUG did fail to properly present the question. AUG admits that its argument that I.C. § 27-9 is subject to preemption by the Bankruptcy Code was first raised in its rehearing brief. AUG admits it failed to raise this argument as an affirmative defense to the Petition for Rehabilitation, that it failed to raise the argument during the rehabilitation proceeding, or to offer evidence in support of its argument, and that it failed to raise the argument on appeal.

It is a general rule of Indiana appellate law that any question or theory which has not been briefed or argued in the briefs on appeal cannot be raised for the first time in a Petition for Rehearing. New York Life Ins. Co. v. Henriksen, 421 N.E.2d 1117, 1118

(Ind.App. 1981). In Henriksen, the Court of Appeals reversed the trial court's judgment and the appellee filed a petition for rehearing asserting for the first time a new argument. As stated on appeal:

> In her petition for rehearing, Ms. Henriksen . . . not only challenges our opinion but seeks relief on a theory not heretofore argued. . . . Ms. Henriksen may not now raise a new argument or espouse a new theory. Any question which has not been briefed or argued in the briefs on appeal cannot be raised for the first time in a petition for rehearing. City of Indianapolis v. Wynn (1959), 239 Ind. 467, 159 N.E.2d 572. The petition is to be confined to those issues which were properly presented in the initial appeal and which were overlooked or improperly decided. Stucker v. College Life Ins. Co. of America (1965), 135 Ind.App. 422, 211 N.E.2d 320. As such, we will not consider Ms. Henriksen's contentions.

421 N.E.2d at 1118. See also City of Indianapolis v. Wynn, 239 Ind. 567, 159 N.E.2d 572 (1959); Hutchinson's Estate v.

Arnt, 210 Ind. 509, 4 N.E.2d 202 (1936); Data Processing Services, Inc. v. L.H. Smith Oil Corp., 493 N.E.2d 1272, 1273 (Ind.App. 1986). This rule has also been applied to questions of constitutionality. Constitutional questions must be raised or argued in the briefs on appeal or they cannot be considered. Kilgallen v. State, 192 Ind. 531, 137 N.E. 178 (1922); City of Indianapolis v. Wynn, 159 N.E.2d 572; Gardner v. City of Bluffton, 173 Ind. 454, 90 N.E. 898 (1910).

In addition, questions regarding the constitutionality of a statute must be raised in the trial court before they can be considered by the Indiana Court of Appeals. Linville v. Shelby County Plan Commission, 258 Ind. 467, 281 N.E.2d 884 (1972); Puntney v. Puntney, 420 N.E.2d 1283 (Ind.App. 1981); Alwood v. Davis, 411 N.E.2d 759 (Ind.App. 1980). AUG did

not raise this question before the trial court. The first time it was raised was in its Petition for Rehearing.

This Court has itself held that raising a federal question for the first time in a petition for rehearing is generally insufficient unless the court actually entertains the petition and expressly decides the question. Radio Station WOW v. Johnson, 326 U.S. 120, 128 (1945); Hanson v. Denckla, 357 U.S. 235, 243-44 (1958); Herndon v. State of Georgia, 295 U.S. 441, 443 (1935):

> Questions first presented to the highest state court on a petition for rehearing come too late for consideration here, unless the state court exerted its jurisdiction in such a way that the case could have been brought here had the questions been raised prior to the original disposition.

Radio Station WOW, 326 U.S. at 128. For example, in Cox Broadcasting Corp. v. Cohn, 420 U.S. 469, 476 (1975), the

Supreme Court's appellate jurisdiction was held properly invoked by virtue of the state court's express holding in denying a petition for rehearing, that "[a] majority of this court does not consider the statute to be in conflict with the First Amendment." In this case, however, the Indiana courts denied rehearing and transfer summarily and without opinion. Thus, there is no language from the Indiana courts indicating that this question was considered and disposed of.

AUG ignores this jurisdictional defect and argues that it could nonetheless properly raise this federal question on petition for rehearing. AUG cites International Longshoremen's Ass'n AFL-CIO v. Davis, 476 U.S. 380 (1986), as being "strikingly similar to this case." However, Davis is distinguishable from

this case in two very important respects. First, the Alabama Supreme Court in Davis, although holding that the International Longshoremen's preemption argument had been waived, stated in a footnote that if it had occasion to reach the merits, it would have found no preemption:

> The instant facts fall squarely within the "peripheral concern" exception to federal pre-emption of state jurisdiction of labor related disputes. (citation omitted.) The National Labor Relations Board has already determined that an employer's supervisors are not protected by the Labor Management Relations Act. Thus, in this case [Davis] has no remedy before the NLRB, and this dispute, although somewhat labor-related, is, at most, only of "peripheral concern" to the NLRB. (citations omitted.)

476 U.S. at 386. Consequently, there was language in the opinion indicating that the federal question had actually been considered and decided. In addition, the

question of whether NLRA preemption was waiveable rested on an erroneous view of the scope of Federal preemption, which was itself a matter of federal law. Thus, there was an actual decision of a federal question. In this case, the Indiana Court of Appeals did not actually decide a federal question. The question of whether I.C. § 27-9 and the Bankruptcy Code conflicted was never raised before the Indiana trial court or before the Indiana Courts of Appeal. The Indiana Court of Appeals did not even make a determination that this question had been waived.

Second, this Court in Davis held that NLRA preemption is not a waiveable defense. That is not the case with the preemption argument being made by AUG. The same question was considered by the court in In re Mader's Store for Men,

Inc., 77 Wis.2d 578, 254 N.W.2d 171 (1977). The court in Mader concluded that the Bankruptcy Act did not put an end to the power of the court to appoint a receiver for an insolvent corporation nor were the statutes declaring or regulating this power generally suspended by the Bankruptcy Code. 254 N.W.2d at 179, 180. Since the general creditor seeking to place the debtor into bankruptcy was not correct in asserting that the receivership provisions were suspended by the Bankruptcy Code, no jurisdictional defect was therefore presented:

> We think it clear that under the circumstances present in the case at bar, a court of equity might have appointed a receiver independent of any statute on the subject. But whether this is so or not, the fact that a receiver has been appointed at the instance of a simple contract creditor is not a jurisdictional defect. It is at

> most an error which may be waived by participating in the receivership as Gelatt has done. (citations omitted.)

254 N.W.2d at 182-183 (Emphasis added). As will be shown in more detail below, since the Indiana trial court's power to issue an order rehabilitating AUG is not suspended by the Bankruptcy Code, no jurisdictional defect was presented by AUG. AUG's argument was a waiveable defense and AUG waived it by failing to present it until the petition for rehearing.

In a last gasp attempt to save itself from these jurisdictional defects, AUG argues that it was shocked and surprised at the Indiana Court of Appeals' opinion; that the Indiana Court of Appeals did not follow the authorities which it had cited and did not consider In re Family Health Services, Inc., 104 B.R. 268 (Bankr. C.D. Cal. 1989), a case decided after this

matter was fully briefed in the Indiana Court of Appeals, but before the court of appeals' decision. However, these cases are not applicable to the question which was decided by the Indiana Court of Appeals. As shown by its opinion, the Indiana Court of Appeals did not overrule any existing law in rendering its decision. The argument that if AUG was subject to § 27-9, then § 27-9 was preempted by the Bankruptcy Code, was simply overlooked by AUG until after the Indiana Court of Appeals' opinion. AUG's arguments prior to the petition for rehearing were limited to claiming that it was not subject to I.C. § 27-9 and that if subject to I.C. § 27-9 then the Commissioner failed to prove sufficient facts which would constitute a statutory ground for a petition for rehabilitation under I.C. § 27-9-3-1. AUG never, before

the petition for rehearing, argued that I.C. § 27-9 was subject to preemption by the Bankruptcy Code. This argument, however, was available to AUG on the day that the Commissioner filed a petition for rehabilitation, May 4, 1988.

Since the Indiana Court of Appeals neither considered nor decided this question, this Court does not have jurisdiction of this matter.

II. AUG is an "insurance company" expressly excluded from the benefits and burdens of the Bankruptcy Code.

Assuming for purposes of argument that AUG has somehow properly raised this question and that this question has somehow been decided by the Indiana Court of Appeals, a rehabilitation proceeding under I.C. § 27-9 against AUG does not subject I.C. § 27-9 to preemption by the Bankruptcy Code because AUG is an

"insurance company" excluded from the benefits and burdens of the Bankruptcy Code. Pursuant to 11 U.S.C. § 109(b)(2) "a domestic insurance company" may not be a debtor under the Bankruptcy Code. Congress enacted this provision excluding insurance companies from the benefits and burdens of "liquidation under the bankruptcy laws because they are bodies for which alternative provision is made for liquidation under various state . . . regulatory laws." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 318-19 (1977); S. Rep. No. 95-989, 95th Cong. 2d Sess. 31 (1977). The rationale for excluding insurance companies from the Bankruptcy Code was explained in Sims v. Fidelity Assurance Ass'n, 129 F.2d 442, 448-449 (4th Cir. 1942):

> No reason for making these exceptions were assigned by the Committees of Congress, but they may be surmised to lie in the

> public or quasi-public nature of the business, involving interests other than those of creditors, and in the desirability of an unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs.

In arguing that it is not an insurance company, AUG relies upon cases which have determined that a health maintenance organization is not an insurance company within the meaning of § 109(b)(2). In re Family Health Services, Inc. (1989), Bankr. C.D.Cal., 104 B.R. 279; In re Family Health Services, Inc. (1989), Bankr. C.D. Cal., 104 B.R. 268. There is a split of authority as to whether a health maintenance organization is an insurance company. See In re Beacon Health, Inc., 105 B.R. 178; In re Portland Metro

Health, Inc. (1981), Bankr. D. Or., 15 B.R. 102. Nonetheless, whether a health maintenance organization is an insurance company is not dispositive of this case. The question to be decided here is whether an attorney-in-fact for a reciprocal insurance company has the status of an insurance company and is excluded from federal bankruptcy relief. This question has been decided previously, and it was decided against AUG. In In re International Underwriters, 157 F.Supp. 367 (W.D. Mo. 1957), the court considered the identical question now being raised -- whether an attorney-in-fact for a reciprocal insurance exchange has the status of an insurance company and is excluded from federal bankruptcy relief. After applying the state classification test and the independent classification test,

the court concluded that the attorney-in-fact was "an insurance corporation for the purposes of the Bankruptcy Act, and falls within the exception provided in Section 22(b), supra."[2/] 157 F.Supp. at 373.

In reaching this conclusion, the court in International Underwriters considered and dispensed with the same

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2/ The alternate relief test had not yet been articulated at the time of the International Underwriters' decision. See In re Republic Trust & Savings Co. (1986), Bankr. N.D.Okl., 59 B.R. 606. However, it, too, supports the conclusion that AUG is excluded from federal bankruptcy relief. The key question of this test is whether a federal bankruptcy proceeding is a satisfactory alternative to a state insolvency proceeding. Family Health Services, 104 B.R. at 277. In this case, it is not. It is not disputed that AIE is an insurance company and therefore not entitled to federal relief. Since AUG is indispensable to AIE because it transacts all business for AIE, both entities should be rehabilitated or dissolved together.

arguments now raised by AUG. In International Underwriters, an involuntary petition for bankruptcy was filed against International Underwriters, Inc., by a creditor. International Underwriters challenged the court's jurisdiction on the ground that it was an insurance corporation and therefore exempt from Title 11 of the Bankruptcy Act. The first argument presented by the creditor was that International Underwriters was not an insurance corporation "for the reasons that it issued no policies, collects no premiums, is not under the regulation of the state insurance department as an insurance company, and does not hold itself out to the public as an insurance company." 157 F.Supp. at 369. The creditor further argued that International Underwriters was but the agent for its principal, International

Indemnity Exchange. The court looked to the policy of insurance and determined that the attorney-in-fact, International Underwriters, was authorized to execute, modify and cancel insurance, and was authorized to collect premiums and to perform and function in many other areas of insurance management. The court also determined that International Underwriters was regulated by the department of insurance.

Similarly, in concluding that AUG was an Indiana insurer doing business in Indiana, the Indiana Court of Appeals properly looked to AUG's Inter-Insurance Certificate of Authority and to the Power of Attorney and Subscribers' Agreement. The Indiana Court of Appeals noted that AUG has the authority to make contracts of insurance. 552 N.E.2d at 52. Also, the Power of Attorney and Subscriber's

Agreement authorized AUG to "effect, modify and terminate contracts" and as stated in AUG's Articles of Incorporation, "to do all other things necessary, incidental, and convenient to carrying on an insurance business." Also, AUG's obligations and duties to the subscribers of AIE and to the Department are regulated by statute. 552 N.E.2d at 51; I.C. § 27-6-6-1 et seq.

It must be noted that under the State Classification Test urged by AUG, the analysis begins with whether the state law classifies the entity as one specifically excluded from being a debtor under § 109(b)(2). Here, while the Indiana Court of Appeals did not consider this question, it did determine that AUG is an insurer doing business in Indiana; it has done and is licensed to do insurance business under a license or

certificate of authority as an insurer issued by the Indiana Department of Insurance. Under the State Classification Test, the Court may also examine the state's statutes for characteristics common to excluded entities, those entities which conduct business of a public or quasi-public nature and are subject to extensive state regulation including a statutory scheme for liquidation or rehabilitation. Family Health Services, 104 B.R. at 273. It is apparent from the language contained in I.C. § 27-6-1-1 et seq., that the Indiana legislature intended and specifically provided for the regulation of the attorney-in-fact for a reciprocal or interinsurance exchange by the Department of Insurance just as it did for the reciprocal or interinsurance exchange. AUG is treated and classified

as other entities excluded from being a debtor under § 109(b)(2).[3/]

Finally, AUG asserts that it does not underwrite or spread risks. Again, this issue was addressed in International Underwriters, 157 F.Supp. at 371. The court in International Underwriters noted that the reciprocal provisions contained

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3/ AUG claims that it is not an insurance company because it was organized under Indiana's general corporate code, I.C. § 23-1, and not under the insurance law. AUG also claims that the absence of the word insurance in AUG's name is significant because I.C. § 27-1-6-3 requires that all insurance companies formed under I.C. § 27-1-6-1 include insurance in its name. AUG fails to note that reciprocal insurers are excluded from the formation provisions of the Indiana Insurance Law. See I.C. § 27-1-6-1. The fact that AUG was not formed under those provisions is of no consequence. As noted by the court in In re Beacon Health, Inc. (1989), Bankr., S.D. Tex, 105 B.R. 178, n.1, "Suffice it to say that if a sign is placed on a duck saying it is 'not a duck' that doesn't mean it is not a duck."

in the policy contained a limitation of liability precluding the attorney-in-fact from assessing the subscriber an additional premium should the claims for losses exceed the funds available for payment of losses. In addition, under Missouri statute, if at any time the amounts on hand were less than those required by law, the subscribers "or their attorney for them" shall make up the deficiency. 157 F.Supp. at 371.

In this case, the power of attorney contains a similar limitation of liability. In addition, I.C. § 27-6-6-6 provides if at any time the assets shall be less than required, "the subscribers or their attorney for them shall make up the deficiency within thirty [30] days after notice from the department of insurance. . . ." Ind. Code § 27-6-6-6 (1988). Thus, both the subscribers and

their attorney-in-fact assume the risk of paying claims. Under these circumstances, risk is assumed under Indiana law. International Underwriters, 157 F.Supp. at 371.

AUG claims that International Underwriters simply is not the law of Indiana. In support of this statement, AUG cites Wysong v. Automobile Underwriters, 204 Ind. 493, 184 N.E. 783 (1933). AUG claims under Wysong, an attorney-in-fact does not assume any risk and is not an insurer. This is incorrect. Under the Wysong decision, if the subscribers or their attorney voluntarily desire to make up the deficiency, they may do so. However, if not, then the State may revoke the right to continue business. Since the power of attorney prohibits AUG from assessing the subscribers to make up the deficiency,

AUG is faced with a decision. It can make up the deficiency and spread risk or be forced out of business. AUG has in the past decided to make up the deficiency and, in fact, invested nearly $8 million. AUG has engaged in risk-spreading.

AUG also completely ignores that language in Wysong which is contrary to its position. In Wysong, the court stated:

> The individuals interested appoint an attorney-in-fact for their particular purpose and business and he takes the place of an insurance company in every particular. . . .

184 N.E.2d at 785. The court in Wysong acknowledged that an attorney-in-fact was an insurance company in every particular.

AUG also claims that International Underwriters is contrary to Underwriters Exchange v. Indianapolis St. Ry. Co., 185 N.E. 504, because "an attorney-in-fact is neither an insurer or an insured." This

language is taken out of context. Underwriters Exchange concerned the question of whether an attorney-in-fact was the real party in interest in order to maintain an action against a tortfeasor who had damaged the property of one of the subscribers. There was no provision in the language of the power of attorney, either express or implied, which authorized the attorney-in-fact alone as plaintiff on behalf of the subscribers to maintain an action in any matter between the subscribers and a third party. See 185 N.E. at 506. Since there was no such language and since the attorney-in-fact had not paid any amounts to the subscribers directly, it could not maintain the action against the third party. In this case, the power of attorney specifically authorizes AUG to appear on behalf of the subscribers "and

to bring, prosecute, defend or otherwise settle suits, actions or proceedings." Under the Underwriters Exchange rationale, AUG could prosecute the action because it is authorized to act as an insurance company in every particular.

An attorney-in-fact is indispensable to the plan of reciprocal insurance. Wysong, 184 N.E. 783. All the business is done and transacted by an attorney-in-fact. As stated by the court in International Underwriters:

> To say that this attorney in fact is not engaged in the insurance business is to completely ignore the efficacy, intention and implications of the statutes of Missouri regulating reciprocal insurance, the reciprocal provisions themselves contained in each insurance policy, the charter powers conferred upon the attorney in fact, its principal activities, and lastly its classification by the State itself.

157 F.Supp. at 373. See also In re Manufacturing Lumbermen's Underwriters, 18 F.Supp. 114, 117 (D.C. 1936).

III. I.C. § 27-9 is not preempted by the Bankruptcy Code.

Even if AUG is determined not to be an "insurance company" under the Bankruptcy Code and, therefore, not excluded from bankruptcy relief, the application of I.C. 27-9 to AUG does not conflict with the Bankruptcy Code.[4/] AUG asserts that "the Bankruptcy Code preempts IC 27-9 specifically as to attorneys-in-fact who act as agents and

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4/ AUG argues that this argument is confusing and misleading. AUG claims that if it is not an insurance company, I.C. 27-9 does not apply. It is AUG who is confused. The Indiana Court of Appeals has determined that AUG is an insurer under Indiana law. I.C. 27-9. The Indiana Court of Appeals did not decide whether AUG was an "insurance company" under the Bankruptcy Code, [Foot note continued on next page.]

not as insurers . . . because they are not excluded from the Bankruptcy Code and therefore cannot be subjected to an insolvency statute such as IC 27-9 which is tantamount to bankruptcy . . . ." (Petition, p. 53.) Although AUG refers generally to the supremacy and preemptive effect of the federal bankruptcy

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[Foot note continued]

4/ and if not whether the Bankruptcy Code preempted I.C. 27-9, because those questions were never raised. Since this Court's only power over state court judgments is to correct them to the extent they incorrectly adjudge federal rights, this Court cannot disturb the Indiana Court of Appeals' decision that AUG is an insurer under Indiana law, even if that decision is incorrect. This Court may, however, determine that I.C. 27-9 is preempted by federal law. As will be shown below, even if this Court finds that it has jurisdiction and that AUG is not an "insurance company" under federal law, I.C. 27-9 still does not conflict with the Bankruptcy Code because no bankruptcy proceedings were initiated in this case and I.C. 27-9 does not provide a discharge to a debtor.

legislation, it makes no attempt to identify the specific theory of preemption under which I.C. § 27-9 is supposedly preempted by the Bankruptcy Code. Similarly, although AUG states that preemption of a state insolvency statute occurs whenever the state law conflicts with the national law of bankruptcy, it makes no attempt to define or explain why I.C. § 27-9 conflicts with the Bankruptcy Code. There are three established theories of preemption under the supremacy clause of the United States Constitution: express preemption of a specific area of state law by federal law; implied preemption of a specific area of state law by a pervasive scheme of regulation under federal law; and preemption of state law to the extent of actual conflict with the federal law. As explained by the United States Supreme

Court, "[a]bsent explicit language, Congress' intent to supersede state law altogether may be found from a 'scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it.'" Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Development Com'n, 461 U.S. 190, 203-04, 103 S.Ct. 1713, 1722 (1983). On the other hand, "where Congress does not entirely displace state regulation in a specific area, state law is preempted to the extent it actually conflicts with federal law" such as "when 'compliance with both federal and state law is a physical impossibility' or where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" Id. at 204, 183 S.Ct. at 172.

On the premise that it is not an insurance company excluded from the benefits and burdens of the Bankruptcy Code, AUG, quoting the early decision of International Shoe Co. v. Pinkus, 278 U.S. 261, 49 S.Ct. 108, (1929), argues that I.C. § 27-9 is preempted because it is the functional equivalent of the Bankruptcy Code and because the conflict between it and the Bankruptcy Code is so fundamental and pervasive. Apparently, AUG is arguing either that I.C. § 27-9 is generally preempted "by a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room to supplement it" or that I.C. § 27-9 is partially preempted to the extent it actually conflicts with "the accomplishment and execution of the full purposes and objectives of Congress."

The argument that the Bankruptcy Code is a pervasive scheme of regulation generally preempting proceedings under I.C. § 27-9 proves too much and is inconsistent with the express provisions of the Bankruptcy Code. Taken to its logical conclusion, such an argument would require preemption of a vast majority of the state courts' undisputed equitable and statutory authority to effect a ratable distribution of the assets of an insolvent debtor among his creditors. See I.C. § 23-2-4-21 (appointment of receive for insolvent retirement home); I.C. § 27-1-47-1 et seq. (involuntary dissolution and "winding up" of insolvent corporations at the behest of creditors); I.C. § 32-12 et seq. (assignment for the benefit of creditors by individuals through trustees or court appointed receivers); I.C.

§ 34-1-12-1 (appointment of receivers for property of individuals, partnerships and corporations in an action by creditors to subject any property or fund to their claims and in other actions). Not surprisingly, the Bankruptcy Code itself expressly acknowledges the continuing validity of such state laws by providing among other things for the turnover of property held by receivers and trustees appointed under state law upon the initiation of proceedings under the Bankruptcy Code and for relief from the turnover provision where the receiver or trustee was appointed under state law more than 120 days prior to the initiation of proceedings under the Bankruptcy Code. See 11 U.S.C. § 543. See also, 11 U.S.C. § 303(h)(2).

The Wisconsin Supreme Court, considering prior versions of the statutes cited above, has stated:

> . . . It cannot be contended that the Bankruptcy Act put an end to the powers of courts of equity in this regard, Hazelwood, supra, nor that statutes declaring or regulating this power are generally suspended by the Bankruptcy Act. . . . We note . . . that today, after nearly eighty years in which bankruptcy legislation has continuously been in force, statutes declaring or regulating in greater or lesser detail the power of courts of equity over insolvent corporations remain on the books and in use in many if not most of the several states.
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> It is apparent from the Bankruptcy Act itself that the states retain considerable freedom of action with respect to insolvent debtors. The fifth act of bankruptcy consists of a person's having
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> > "While insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property." 11 U.S.C. sec. 21(a)(5).

> Sec. 2a(21) of the Act authorizes the bankruptcy courts to require delivery to the trustee in bankruptcy of assets in a state court receiver's hands, provided the receiver was not appointed more than four months before the date of bankruptcy. [Footnote omitted]. In our opinion, these provisions reflect a congressional intent generally to preserve the validity of receiverships, whether voluntary or involuntary, created under state law, unless and until such proceedings are displaced pursuant to sec. 2a(21) by proceedings in a court of bankruptcy.

In re Mader's Store for Men, Inc., 254 N.E.2d 171, 179-80 (citations omitted, emphasis supplied). See also, Gallagher v. Keystone Realty Holding Co., 333 Pa. 9, 3 A.2d 426, 428 (1939). (The Supreme Court of Pennsylvania held that "[t]he Insolvency Act is not inconsistent with the Bankruptcy Act . . . simply because it authorizes appointment of a receiver in the circumstances alleged.")

Despite the sweeping statement quoted by AUG from the early decision of International Shoe Co. v. Pinkus, state laws which result in a ratable distribution of the assets of an insolvent debtor among his creditors are not generally preempted by a "pervasive scheme of regulation" established by the Bankruptcy Code. This fact is confirmed by the United States Supreme Court's decision in Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933), decided four years after Pinkus.

The fact that such laws are not generally preempted by the Bankruptcy Code does not, of course, exclude the possibility that the particular incidents of a state law might conflict with the Bankruptcy Code by obstructing the accomplishment and execution of the full purposes and objectives of Congress and

be subject to partial preemption under the actual conflict theory of preemption. However, there has historically been some uncertainty as to the standard upon which an actual conflict between a state law and the Bankruptcy Code is to be determined to exist. As explained and clarified by the Wisconsin Supreme Court:

> Some of the uncertainty in the area is traceable to the sweeping language used by the United States Supreme Court in International Shoe Co. v. Pinkus, supra. Courts have examined state legislation with an eye to determining whether it "occupies the same field" as the federal Act or offers a competitive alternative thereto. However, in Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 53 S.Ct. 262, 77 L.Ed. 469 (1933), a case decided after International Shoe Co. v. Pinkus, supra, the court upheld the provisions governing assignments for the benefit of creditors then contained in ch. 128, Wis.Stats., noting in the process that if creditors of the corporation so desired, they could put an end to the state assignment proceedings by instituting bankruptcy proceedings within the statutory

> four-month period. An assignment for the benefit of creditors results in the ratable distribution of non-exempt assets of an insolvent debtor among his creditors just as do proceedings in bankruptcy, and the bankruptcy court is available, as an alternative to the assignment proceedings, to the debtor and in most cases to his creditors as well. It is apparent that state legislation does not encroach in a forbidden way upon the field occupied by the Bankruptcy Act merely because it provides for a distribution of the assets of an insolvent corporation among its creditors, and we think this is true whether the proceeding is voluntary or involuntary in its inception. International Shoe Co. v. Pinkus must be read in the light of the Pobreslo Case, and the fact that the condemned Arkansas statutes provided for discharge of the debtor.

In Re Mader's Store for Men, Inc., 254 N.W. 2d at 181-82. (Emphasis supplied).

In light of the numerous undisputed state statutes which so provide, the express provisions of the Bankruptcy Code itself, and the United States Supreme Court's decision in Pobreslo v. Joseph M.

Boyd Co., the fact that a state law compliments or augments the Bankruptcy Code to some extent by providing a ratable distribution of the assets of an insolvent debtor among his creditors does not present an actual conflict with the Bankruptcy Code which requires the statute's partial preemption. Rather, construing International Shoe Co. v. Pinkus in light of Pobreslo, it becomes clear that a state statute presents an actual conflict with the Bankruptcy Code, and, is therefore subject to partial preemption, only when it interferes with the access of a debtor or his creditors to the benefits and burdens of the Bankruptcy Code, In Re Mader's Store for Men, Inc., 254 N.W.2d at 182, such as when a state statute purports to provide a debtor a discharge from his debts thereby eliminating the access of the

debtor's creditors to proceedings under the Bankruptcy Code, Pobreslo, 287 U.S. at 526, 53 S.Ct. at 264, distinguishing Pinkus, 278 U.S. at 268, 49 S.Ct. at 111 or, when a state statute purports to suspend the driver's license and registration of any motorist who failed to satisfy a judgment against him, even if the motorist received a discharge under the Bankruptcy Code, thereby eliminating the benefit of the discharge provided by the Bankruptcy Code. Here, I.C. § 27-9 does not interfere with the access of a debtor or his creditors to the benefits and burdens of the Bankruptcy Code.

In sum, AUG, through bold assertions, general references and superficial analysis, argues that the application of I.C. § 27-9 to it, as a debtor subject to the benefits and burdens of the

Bankruptcy Code, is preempted by the Bankruptcy Code. However, closer consideration dictates the conclusion that I.C. § 27-9 is not subject to general and partial preemption simply because it compliments or augments the Bankruptcy Code to some extent by providing for the ratable distribution of the assets of an insolvent debtor among his creditors. Moreover, closer consideration dictates the conclusion that I.C. § 27-9, as necessarily construed to permit the initiation of bankruptcy proceedings, does not limit the access of a debtor or his creditors to the benefits and burdens of the Bankruptcy Code and, therefore, is not subject to partial preemption by the Bankruptcy Code. Clearly, even if AUG were not excluded from the Bankruptcy Code, the application of I.C. § 27-9 to

AUG would not be preempted by the Bankruptcy Code and the proceedings thereunder against AUG would not be suspended, if at all, unless and until bankruptcy proceedings were initiated under the Bankruptcy Code. Here, no such proceedings were initiated.

IV. AUG has not raised a substantial federal question.

As shown above, the question now raised by AUG was not properly presented to the Indiana Court of Appeals and the Indiana Court of Appeals did not consider or decide it. However, even if this question was presented to and considered by the Indiana Court of Appeals, it does not merit the review of this Court. The same question as raised here was considered and decided in In re International Underwriters, 157 F.Supp.

367 (W.D. Mo. 1957), where it was determined that an attorney-in-fact for a reciprocal insurance exchange has the status of an insurance company and is excluded from federal bankruptcy relief. In re International Underwriters applied the state classification test and the independent classification test in concluding that the attorney-in-fact was an insurance corporation for the purposes of the Bankruptcy Code. In this case, the Indiana Court of Appeals has already determined that AUG is an insurance company pursuant to I.C. § 27-9. That determination turns upon its own facts. AUG has a certificate of authority issued by the Department of Insurance which authorizes it "to make contracts of insurance." A decision by this Court would not be as far reaching as AUG insists. AUG has not raised a

substantial federal question which would merit the review of this court.

CONCLUSION

For all the foregoing reasons, the Commissioner respectfully requests that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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